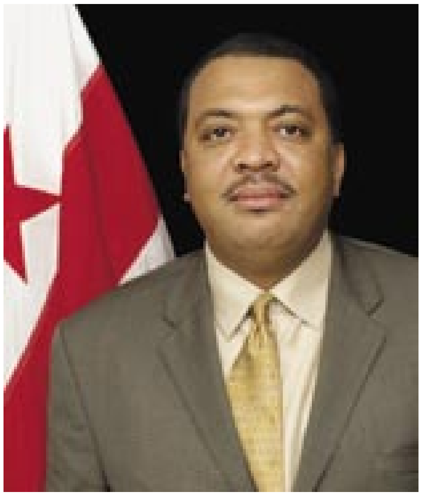
THE CAPITAL CONNECTION

News from the Department of Insurance, Securities and Banking — *December/January 2006*

Greetings From Acting Commissioner Thomas E. Hampton

On Sep. 30, 2005, D.C. Mayor Anthony Williams appointed Thomas E. Hampton as the acting commissioner of the Department of Insurance, Securities and Banking (DISB), where he had served previously as the deputy commissioner.



I am truly honored to lead one of the most progressive agencies in the Government of the District of Columbia. This is an exciting time for Washington, D.C., and our agency. Thanks to the leadership of former Commissioner Larry Mirel, we have

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Introducing The Capital Connection

The Capital Connection, a bi-monthly publication from the Government of the District of Columbia Department of Insurance, Securities and Banking, will replace the agency's former newsletter, *The Financial Gateway Express*. It is done in-house by the department's office of communications. For more information, visit its Web site at www.disb.dc.gov. Please feel free to forward this newsletter to colleagues and other interested parties. If you would prefer not to receive this publication, contact Michelle Phipps-Evans at 202-442-7822 or send an e-mail to michelle.phipps-evans@dc.gov. Type REMOVE in the subject line.

Working Together to Protect the District's Consumers

By Councilmember Jim Graham (D-Ward One)

It has been almost a year since I became chair of the Council of the District of Columbia's Committee on Consumer and Regulatory Affairs. I knew it would be a challenging assignment for many reasons, not the least of which was the committee's oversight on consumer protection. On paper, we have some of the nation's strongest consumer protection laws. But the strength of a law depends on its enforcement. And for years, our consumer protection laws simply weren't being enforced enough.

For more than 10 years, consumer protection took a back seat as the council and the mayor focused on other things. In the last days of 1994, the council took away most of the funding for enforcement of the Consumer Protection and Procedures Act. But the need for enforcement didn't simply disappear. The Better Business Bureau (BBB) reported more than 3,600 complaints against District businesses last year. Other nonprofit groups and legal clinics have joined the BBB to help consumers, and the office of the attorney general takes action on customer complaints. Yet the District government has remained largely on the sidelines of this important arena. Now that our economy has rebounded and our treasury is in better shape, we must make consumers a priority again.

The committee and the executive branch, in this case the Department of Insurance, Securities and Banking (DISB) and the Department of Consumer and Regulatory Affairs (DCRA) have been working together to reinvigorate consumer protection programs. In the budget for fiscal year 2006, the council has added $800,000 as a first-year initiative to staff an office of consumer protection under DCRA; and it has authorized two additional positions for DISB to hire trained staff to work full time in areas where consumers need protection the most – insurance fraud and predatory lending.

Predatory lending describes a set of loan terms and practices that fall between appropriate risk-based pricing by sub-prime lenders and blatant fraud. This unscrupulous practice typically affects our most vulnerable residents: those who cannot get loans through traditional channels because of income or credit limitations. And, in a red-hot real estate market like the District of Columbia, accessing capital to buy a home is becoming a problem for the middle class as well. The Center for Responsible Lending estimates that predatory mortgage lending costs Americans more than $9.1 billion a year. The experts at DISB will help District consumers become aware of their rights, and take action against unsavory lenders. I look forward to working with Acting Commissioner Tom Hampton and the DISB staff to protect all District residents—especially the most vulnerable among them—from those who seek to defraud and who give legitimate businesses a bad name.

Ten Best Practices For Investment Advisers

The North American Securities Administrators Association (NASAA), the association of state, provincial and territorial securities regulators in the United States, Canada, and Mexico, is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities. NASAA has recently recommended 10 best practices to help investment advisers develop effective compliance practices and procedures. The following list of best practices emerged from 367 examinations conducted in 2005 under the auspices of NASAA's coordinated investment adviser examination project.

- Review and revise Form ADV (uniform application for investment adviser registration), and the disclosure brochure annually to reflect current and accurate information.
- Review and update all advisory contracts annually.
- Prepare a written supervisory procedures manual relevant to the type of business and the specific activities of the particular investment adviser.
- Prepare and distribute a privacy policy upon entering an advisory relationship with a client, and review annually.
- Prepare and maintain all required records.
- Maintain a surety bond, if required.
- Prepare and maintain client profiles.
- Calculate and document fees correctly.
- Review and revise all advertisements, including performance advertisements and Web sites.
- Implement appropriate custody safeguards, if applicable.

If you are a licensed investment adviser conducting business in the District of Columbia, DISB encourages you to use the aforementioned list to develop practices and procedures that will help you avoid regulatory issues with DISB, and to protect your interests and those of your clients.

Greetings (from page 1)

completed a merger that added banking to the department's regulatory functions, and have introduced a series of measures to modernize the financial regulatory process to streamline the way we conduct business. Today, DISB is an agency that values and provides fair, efficient and effective regulations for all financial service companies in the District of Columbia; provides protection of the District's citizens; and facilitates the economic revitalization of the nation's capital.

While it is impossible to list all the exciting news at DISB, I want to share with you a few highlights:

• Our Insurance Bureau and Risk Finance Bureau have recently renewed their accreditation under the National Association of Insurance Commissioners for five-year terms.

• We have significantly improved the department's customer service. In the third quarter of 2005, in the District government's overall customer-service testing, DISB received the fourth highest score of all D.C. agencies.

• Washington, D.C., is now one of the fastest growing and leading captive domiciles in the nation, having licensed 55 captives in the District since we enacted the captive insurance law in 2000, and we have five more captives currently in the application review process.

• Our agency is more proactive in public communication and outreach. We have had comprehensive Web site improvements; we have resumed the external newsletter; we have been organizing more public meetings for new initiatives; and we are developing an investor-education program.

• We are working with the Council of the District of Columbia to enact legislation to better protect public interests. Examples are the Uninsured Motorist Coverage Bill for the District's taxicab drivers and the Health Reinsurance Bill that would provide health coverage for certain D.C. citizens who are ineligible for Medicaid or the D.C. Health Alliance health services.

• DISB is playing a more active role in the District's economic development. Banks and insurance companies will soon be informed of opportunities to invest in key neighborhoods and commercial corridors as part of the District's Great Streets Initiative. In addition, we will be doing our part in increasing commercial banks' presence in underserved areas around the city; and promoting the Certified Capital Companies Program (CAPCO), an innovative economic development tool that uses tax credits for insurance companies to provide growth funds for promising local small businesses.

Financial services are integral to the economic development of our city and the quality of life of our citizens. It is my goal to continue the momentum of making Washington, D.C., a world-class financial capital by attracting more financial businesses, protecting and educating our consumers on financial service issues, developing innovative ways of addressing health insurance concerns of uninsured D.C. residents, and improving communication with the public on our services. Indeed, 2006 will be a busy year.

I hope you find our newsletter informative and valuable. Happy Holidays!

Thomas E. Hampton
Acting Commissioner

Government of the
District of Columbia
Anthony A. Williams, Mayor

DISB's Insurance Bureau Joins Multi-State Online Review Program

Acting Commissioner Thomas E. Hampton is pleased to announce that DISB has recently joined the Multi-State Review Program (MSRP), which offers insurance companies the opportunity to submit simultaneously an individual, online annuity filing to the District of Columbia and the following six states—Florida, Texas, California, Nevada, Georgia and Louisiana.

"Participating insurers enjoy a noticeable increase in their products' speed to market and a reduction in administrative costs," Hampton said.

Each paperless submission offers insurers the opportunity to obtain approval in 60 days or less, and reach more than one-quarter of the country's annuities market. Annuity filers use Florida's online I-File system to submit filings, which are subject to the combined annuity review standards of Florida, Texas, and California while providing companies a simultaneous product approval in all participating states, including the District of Columbia. Company participation in the MSRP is free, and only requires an Internet connection, although some participating state filing fees may apply.

DISB Promotes CAPCO

Business owners and small business advisors attended DISB's *CAPCO and Surety Bonding—Tools for Small Business Growth,* last Dec. 8. The District of Columbia's Certified Capital Companies program (CAPCO) is a new economic development tool that offers premium tax credits to insurance companies in exchange for their investment in venture capital funds, or CAPCOs, which in turn provides growth capital to local small businesses. This innovative approach to small-business development has been adopted by several other states successfully.

"DISB is throwing its full support behind the CAPCO program," said DISB Acting Commissioner Thomas E. Hampton at the seminar. "We believe that it will provide a valuable tool for the small-business community." Co-sponsored by the Washington, DC Economic Partnership and the D.C. Coalition for Capital, the two-hour long seminar featured Councilmember Kwame Brown (D-At-Large) who offered remarks, the Surety Association of America, and CAPCO fund managers. The program, the first in a series of outreach meetings and seminars, was designed to further promote CAPCO and better educate small businesses about the program's benefits, and on surety bonding and access to capital.

DISB's Risk Finance Bureau currently administers CAPCO, which

DISB Acting Commissioner Thomas E. Hampton welcomes the audience to the CAPCO and Surety Bonding—Tools for Small Business Growth seminar on Dec. 8 at the Washington, DC Economic Partnership.

provides both risk-transfer for insurance companies, and access to venture capital for promising small businesses based in the District of Columbia that might be considered too risky to secure bank loans. The certified venture capital funds, CAPCOs, are required to maintain their principal offices within the District of Columbia in addition to meeting other criteria. For example, CAPCOs must make investments in qualified businesses within specified time periods or face decertification. Currently, there are three CAPCOs certified to conduct business in the District: Enhanced Capital District Fund, Advantage Capital DC Partners, and Wilshire DC Partners.

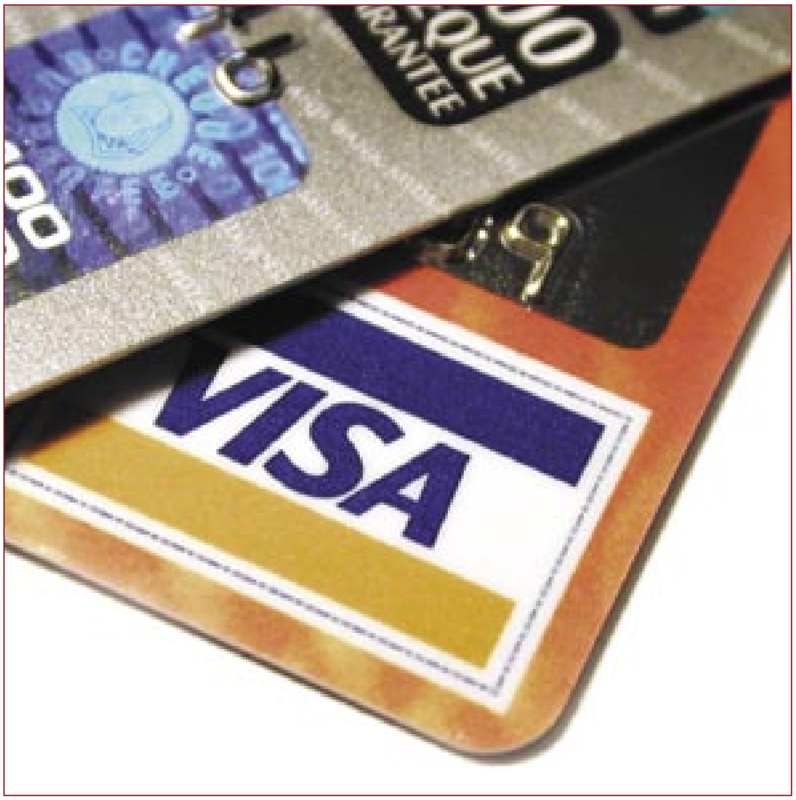
A qualified business is one that meets the U.S. Small Business Administration's definition of a small business, based in the District, employs at least 75 percent of their employees physically in the District of Columbia, has at least 25 percent of its employees living in the District, and is unable to obtain conventional financing. Any type of business can qualify except professional services provided by accountants, lawyers and physicians. Since the program's launch in May 2005, six local small businesses have received a total of $8.3 million from the CAPCOs out of $50 million available premium tax credits for the program. Another local company is expected to receive funding before the end of the year.

To learn more about the District's CAPCO program, please visit DISB's Web site at www.disb.dc.gov or the CAPCO Web site at www.dccapital.org.

At-Large Councilmember Kwame Brown (right) talks about his support for the CAPCO program and surety bonding at the DISB-sponsored joint seminar on Dec. 8. Listening are (left to right) Lenore Marema, vice president of government affairs, Surety Association of America, and DISB Acting Commissioner Thomas E. Hampton.

Friend or Fraud? Recognizing Affinity Fraud

Affinity fraud is a form of investment fraud by which fraudsters prey upon members of certain groups and exploit their trust for financial gain. Purveyors of affinity fraud are known to use the byline, "You can trust me because I'm like you." Their reported victims have included members of religious and ethnic groups, the elderly, social clubs and professionals.



Loyalty within groups has, and continues to make it difficult for law enforcement to detect and prosecute affinity fraud. Some groups refuse to believe that fraud has occurred, and some may even continue to participate in the investment, hoping that faith and trust will bring them financial success. Or, if group members recognize that fraud has occurred, they may attempt to work things out without notifying securities regulators and law enforcement. These tactics prolong the problem and can cause larger financial losses.

Affinity can be used to execute many types of financial fraud. Some fraudsters pose as financial professionals who provide investment advice that fits within the beliefs or customs of the group when, in fact, they are simply stealing from trusting group members. "Ponzi" and pyramid schemes are common types of affinity fraud. In these cases, the fraudster is at the top of the pyramid and commences to recruit investors. After a few investors buy in, the fraudster uses some of that money to make payments back to them. This gives the false impression that the investment has been successful. Satisfied with their returns, unsuspecting victims will convince additional people to invest. These schemes are usually exposed when the fraudster stops making payments and starts making excuses. When unhappy investors start asking questions, they generally discover that most, if not all, of their money is gone.

DISB advises individuals to protect themselves from affinity fraud by doing the following:

• Check with the DISB Securities Bureau. Before investing, make sure that the investment opportunity is registered and that the salesperson or promoter is licensed to sell securities in the District of Columbia. An unregistered investment that does not qualify for exemptions or an unlicensed salesperson may be a warning sign of fraud.

• Keep emotions in check. Emotions can strongly influence financial decisions. No matter how trustworthy the investment promoter seems, do not rush into an investment before you check it out. Sometimes, the promoter may not know that he may be involved in a scam.

• Establish a paper trail. Since trust is the basis of affinity fraud, a fraudster may tell you that documentation is not necessary. Always ask for written information about the investment. Obtain receipts for all transactions. Be skeptical if you are told to operate on a cash-only basis or to make checks payable directly to a personal account.

• Ask questions and read the fine print. All investments involve risks. Make sure you understand those risks before you invest. Read contracts before you sign. Look for strange clauses or inconsistent information. Be cautious if asked to recruit other investors. After you invest, continue communicating with the salesperson or promoter. Pay attention to your statements. Question strange fees or unauthorized transactions.

• Beware of pleading e-mails and Web sites. The Internet has become a way for fraudsters to target specific groups at lightning speed. The quality of these e-mails and Web sites range from sloppy to slick. Some even mimic credible organizations. When in doubt, click "delete."

• If you suspect affinity fraud, report it immediately. For affinity fraud to be successful, fraudsters rely on the faithful participation of their victims. Protect yourself and report suspicious investment programs to the DISB Securities Bureau at (202) 442-7800 or visit the DISB Web site at www.disb.dc.gov.

Investor Education @ Your Library

The American Library Association (ALA) and the Investor Protection Trust (IPT) are teaming up with the editors of *Kiplinger's Personal Finance* magazine to implement investor education in America's public libraries. **Investor Education @ Your Library®** is funded by a grant from IPT, a nonprofit organization dedicated to investor education. This new initiative is part of ALA's Campaign for America's Libraries.

The District of Columbia Public Library System is one of 20 public libraries nationwide selected to host investor education seminars, beginning in February 2006. Libraries will be provided with customized materials developed by ALA, IPT, and Kiplinger, including seven booklets on different investing topics and a DVD set of IPT's national "Money Track" series that is aired on PBS stations.

The investor education booklets tackle the basics of several key investor topics such as stocks and bonds, and are designed for the beginning, intermediate and long-term investor who has never learned the basics. Each booklet includes a glossary of terms and information on the role of state securities regulators and how to contact them. The booklets are:

- *Five Keys to Investing Success*
- *Mutual Funds: Maybe All You'll Ever Need*
- *Getting Help With Your Investments*
- *Maximize Your Retirement Investments*
- *The Basics for Investing in Stocks*
- *A Primer for Investing in Bonds*
- *Where to Invest Your College Money*

The DISB Securities Bureau staff will provide presentations on investor protection for residents of the District of Columbia during an hour-long **Investor Education @ Your Library** seminar, scheduled tentatively this spring at the Martin Luther King Jr. Memorial Library at 901 G St. NW, Washington, D.C. If you are interested in attending the seminar, please contact the library at (202) 727-1171.

About DISB

The Government of the District of Columbia Department of Insurance, Securities and Banking is the District of Columbia's principal financial regulatory agency that regulates and enforces laws on the insurance, securities and banking entities licensed to conduct business in the District of Columbia.

The department's mission is to protect the interests of District of Columbia consumers from unfair and abusive practices, and to provide a fair and equitable business arena for the regulated entities operating in the District of Columbia.

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What is Predatory Lending?

Predatory lending has been described as a variety of lending practices that may be disadvantageous to the borrower. While regulators, the banking industry and advocates have not agreed on a single definition, most have agreed that predatory lending practices are commonly associated with payday loans, check cashing and residential mortgages. Loans become predatory when they target a particular population, take advantage of the borrower's inexperience and lack of information, manipulate a borrower into a loan the borrower cannot afford to repay, or defraud the borrower or investor. Enforcement experience and public hearings have identified tactics that are directed at particular populations such as the elderly and low-income minorities, both of whom are perceived as more vulnerable to predatory practices.

It is difficult to measure the extent to which a borrower is victimized in predatory lending cases for several reasons. Consumers may not be aware that they have received an unfairly priced loan or have been preyed upon in some way. Or, they may choose not to report incidents to regulators. Lending data filed by banks and other lenders is often difficult for regulators to assess, and monitoring questionable lending practices is often open to differing interpretations.

The Government of the District of Columbia Department of Insurance, Securities and Banking has provided consumers with helpful information that aids in identifying potential predatory lending practices. Consumers are advised to be aware of such practices when seeking various forms of consumer loans including residential mortgages.

• Credit insurance may not be worth the price. Credit insurance may include life, disability, unemployment or property insurance when purchased with a loan. This is usually a bad idea. Credit insurance may be overpriced and difficult to collect. When the cost of the insurance is rolled into the balance due on the loan, the lender profits even more by charging interest on the higher balance. Some lenders have begun charging a monthly fee for insurance rather than rolling it into the debt and charging interest. But even this is expensive and can be abusive, sometimes costing the borrower hundreds of dollars each year.

• Excessive fees can add thousands to the cost of the loan. Predatory lenders see fees as the best way to make quick money. In one example, a lender faced a class-action lawsuit for charging borrowers fees equal to 25 percent of a home loan amount while portraying the loans as "no-cost," given that the fees were all added to the balance of the loan and did not have to be paid in full at closing. Borrowers should insist on receiving a good-faith estimate at the time of the loan application, and on reviewing documents the day before closing to scrutinize fees. If fees paid to a lender or mortgage broker total more than five percent of the total loan amount, borrowers should consider postponing closing and seeking another loan.

• Watch out for abusive prepayment penalties. One fee that is often overlooked by borrowers is called a prepayment penalty. These hidden, confusing fees trap borrowers in high-rate loans, which lead to foreclosures. A common example of an abusive prepayment penalty is six months' interest on the outstanding balance if prepayment is made during the first five years of a loan.

• Mandatory arbitration takes away your right to a day in court. Mandatory binding arbitration clauses insulate unfair and deceptive practices from effective review and relegate consumers to a forum where they may not obtain injunctive relief against wrongful practices; proceed on behalf of a class; or obtain damages.

• Sub-prime lenders want to steer consumers into high-cost loans even if the consumer has good credit. While lenders often send borrowers with less-than-perfect credit to their sub-prime affiliates, too few refer borrowers for a lower-priced loan. Studies have suggested that steering has a racial impact given that the practice seems to be aimed at borrowers in minority neighborhoods. To protect themselves from this abuse, borrowers can shop around and consult with housing counselors certified by state agencies before applying for a loan.

Residents of the District of Columbia with questions about lending practices should contact DISB at (202) 727-8000 and ask for the Banking Bureau Licensing Division.

The District of Columbia Receives "A+" for Captive Insurance Success

The District of Columbia's success in attracting captive insurance companies landed it an A+ grade from independent consulting firm Johnson Lambert & Co., which conducted a study on the financial impact of captives on the District of Columbia.

The growth rate of D.C. captives has surpassed its biggest onshore competitor, Vermont, making the District a leading captive domicile in the nation, according to Johnson Lambert's recently released second annual D.C. Captives Report. By September 2005, the Government of the District of Columbia Department of Insurance, Securities and Banking had licensed 53 captive insurance companies from a variety of industries, a remarkable record since the captives insurance law was passed five years ago by the Council of the District of Columbia.

The most dramatic growth occurred in 2004, when the gross premiums written by the captives more than tripled those from 2003, with a total underwriting profit of $8.7 million to date, and tax revenue paid to the District of Columbia estimated at more than $1 million by the end of 2005.

The District of Columbia's high concentration of knowledge-based industries and professionals make it an ideal domicile for captives, which can tap into a wealth of business resources. Its reputation as the nation's capital also makes Washington, D.C., an attractive alternative to other domiciles. In addition, the District's laws on captives insurance, revised in 2004 to make it easier for existing captives to transfer from any jurisdiction including foreign countries to the District of Columbia, has helped several companies relocate with ease to the city.

To learn about the District's captive insurance program or how to set up a captive in the District, please contact Dana Sheppard, director, Risk Finance Bureau, at (202)727-5074; or Lee Backus, assistant director, at (202)535-1419.

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